The City of Lynchburg, Virginia

AGENDA ITEM # 1

MEMORANDUM

To: City Council
From: Michael W. Hill, Director of Financial Services
Date: February 20, 2003
Subject: Financial Trend Monitoring System (FTMS)

Before the beginning of annual budget deliberations, it is prudent to review recent financial trends based on actual experience. While the City has historically prepared multi-year financial forecasts for the General Fund, accessing other methods that will enhance these forecasts continue to be evaluated. A tool that has been utilized by many local governments is the Financial Trend Monitoring System (FTMS) developed by the International City/County Management Association (ICMA) in conjunction with the Government Finance Officers Association (GFOA) and a major accounting firm. One important advantage of this system is that the analytical techniques it includes follow many of the same approaches used by the municipal credit rating industry. These techniques can help the City analyze and interpret financial, economic, and demographic trends of all kinds. Trend analysis is important in understanding financial condition. Such analysis can help the City focus on important trends in areas such as debt issuance, tax collection, operating results, and economic base. Not only is the FTMS a valuable management tool; it can also provide a framework for improving the City's overall financial management and decision-making processes.

Development of the FTMS for the City is very timely with the annual budget deliberations that will follow over the next several weeks. These budget deliberations may be enhanced with a general understanding of the City's financial trends.

As the attached information is reviewed, there are two considerations that are important to understand the trend data:

- Warning Trend

  With each chart/indicator there is a warning trend which serves as a benchmark to evaluate the City's past performance/trend; and,
- Consumer Price Index

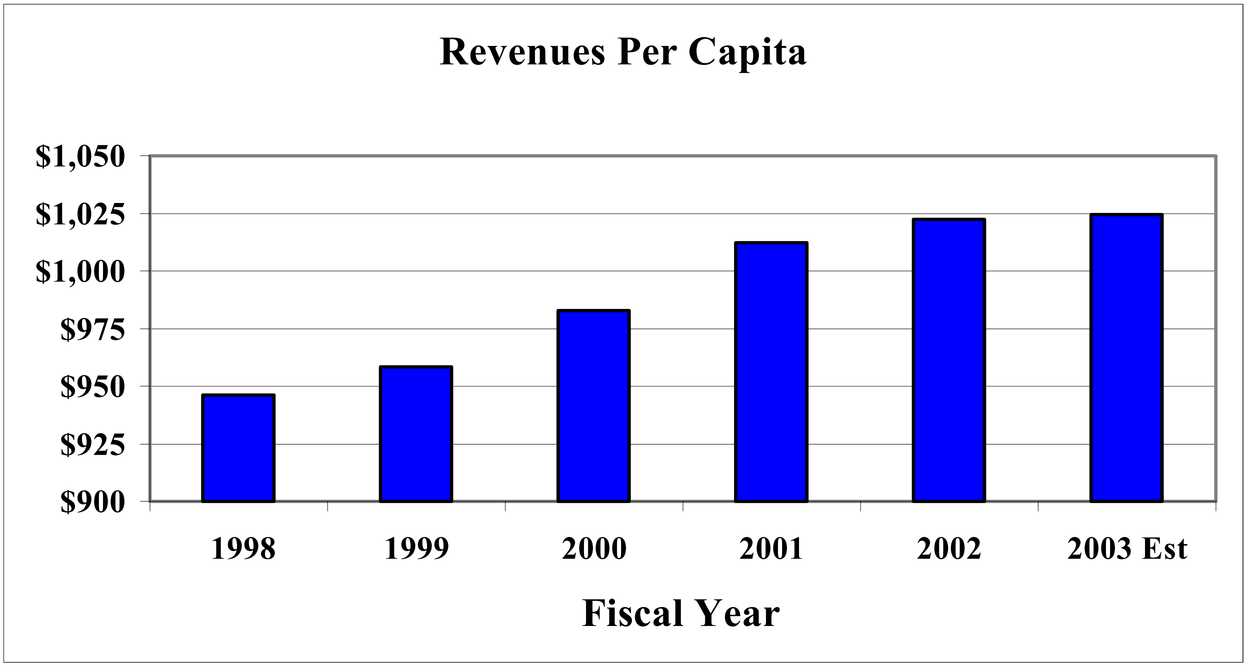
  Where appropriate, trend data has been adjusted for changes in the Consumer Price Index to reflect past performance in constant dollars.

The attached financial trend information will be presented at the February 25, 2003 City Council work session.

Respectfully submitted,

Michael W. Hill, CPA
Director of Financial Services

Revenues Per Capita

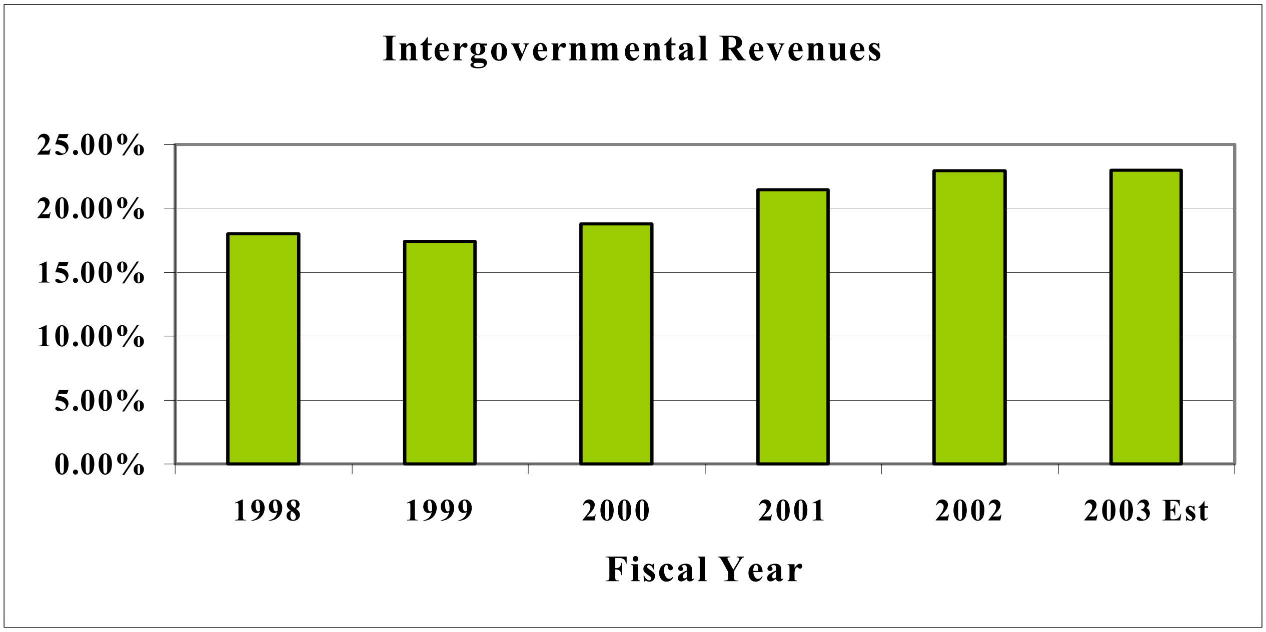


Warning Trend:
Decreasing net operating revenues per capita
(constant dollars)

Description:
Examining per capita revenues shows changes in revenues relative to changes in population size and rate of inflation. As population in Lynchburg has not increased, it might be expected that revenues and the need for services would remain proportionate, and therefore the level of per capita revenues would remain at least constant in real terms. However, the City must examine demographics of its constant population to determine if per capita revenues are likely to be stable when assessing this trend indicator.

Analysis:
Non-recurring revenues have been eliminated to reflect only recurring revenues so that a valid comparison can be made. Non-recurring revenues include (a) FY 1998-$5,294,944, (b) FY 1999-$800,000 and, (c) FY 2000-$924,167. These non-recurring revenues are primarily attributable to one-time grants from FEMA, and grants from the Governor's Fund for Frito-Lay and Ericsson. For the three years before FY 2001, the average growth in revenues per capital was 1.6%. For FY 2001, per capita revenues increased by 3.7%. The growth for FY 2001 was primarily attributable to the increased revenue from the development along Wards Road. With the downturn in the economy and a slight decline in population, current growth patterns are virtually flat.

Intergovernmental Revenues

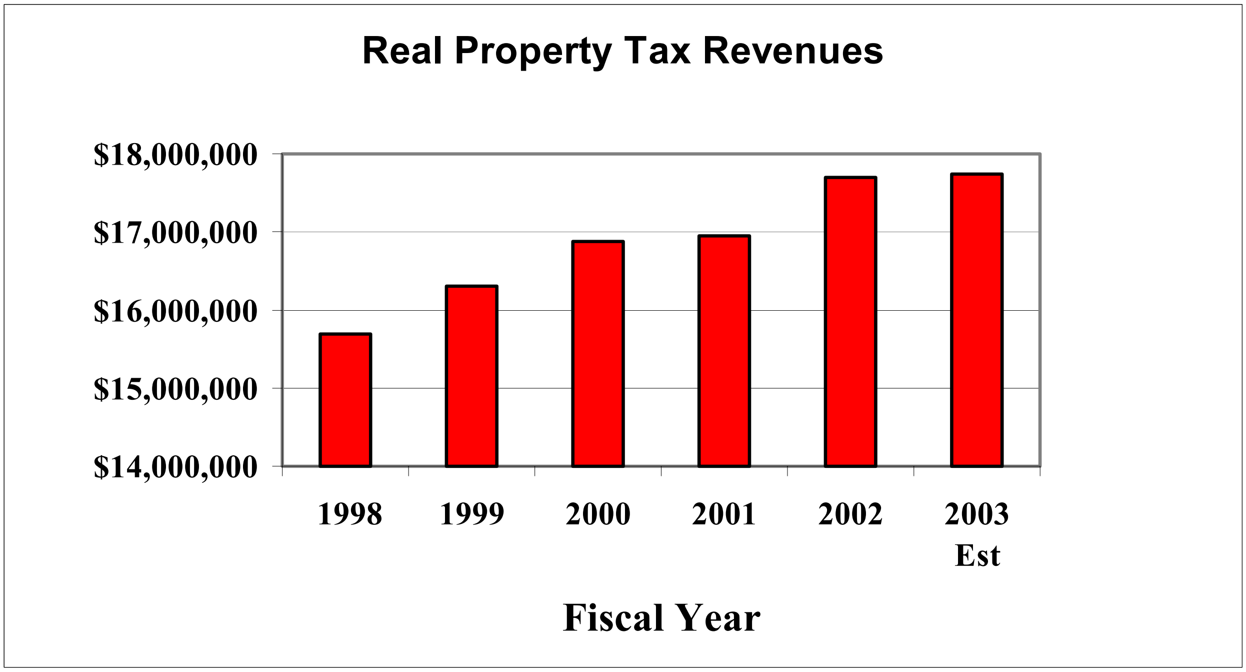


Warning Trend:
Increasing amount of intergovernmental operating revenues as a percentage of gross operating revenues

Description:
Intergovernmental revenues are important because an overdependence on such revenues can be harmful. The Federal and State governments have struggled with their own budget problems and frequently have withdrawn or reduced payments to local governments. The primary concern in analyzing this trend is to monitor the City's vulnerability to reduction in such revenues. However, reductions in intergovernmental revenues would necessitate a review of service levels, as local revenues would be needed if service were to continue at current levels.

Analysis:
FY 1999 was the first year of operation for the Blue Ridge Regional Jail. After FY 1998, State revenues for care of prisoners was directed to the Blue Ridge Regional Jail rather than the City. In FY 2000 the State increased the allocation from HB 599 by $1.4 million from $1.1 million the previous year to $2.5 million and began the first year of reimbursement for the car tax in the amount of $1.9 million. For FY 2001, the major change occurred with the car tax revenue increasing from $1.9 million to $3.6 million. With the reimbursement percentage increasing from 47% to 70%, $5.3 million was received in FY 2002 with $5.5 million estimated for FY 2003. Despite the loss of State monies in some revenue sources, there have been increases in other intergovernmental revenues that result in virtually the same percentage of intergovernmental revenues for FY 2003 compared to FY 2002.

Real Property Taxes

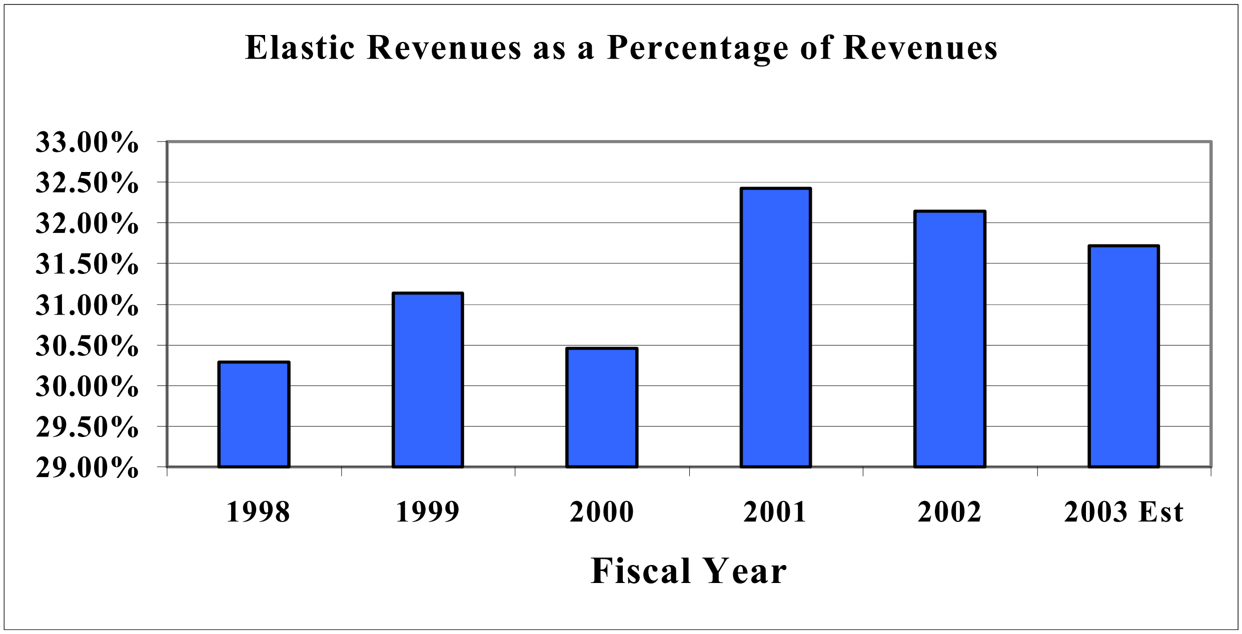


Warning Trend:
Decline in Real Property Tax Revenues
(constant dollars)

Description:
Most governments rely heavily on property taxes. The amounts reflected have been adjusted to account for inflation.

Analysis:
FY 1998, FY 2000 and, FY 2002 represented a year of general reassessment of real property. Real Property Taxes account for roughly 25% of the City's General Fund revenues. During FY 2002 the City began to prorate real estate assessments on new construction that amounted to $270,000 of additional revenue.

Elastic Tax Revenues



Warning Trend:

Decreasing amount of elastic operating revenues as a percentage of net operating revenues

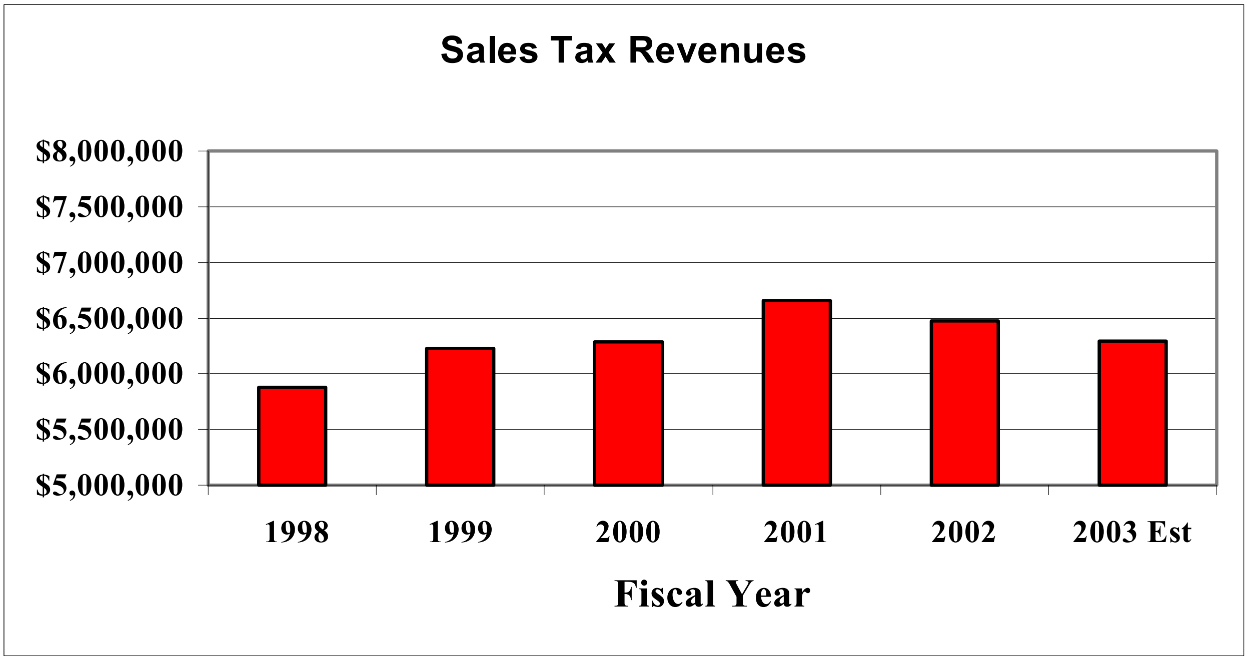
Description:

The yields of elastic revenues are highly responsive to changes in the economic base and inflation. As the economic base expands or inflation goes up, elastic revenues rise roughly in proportional or greater amounts, and vice-versa. Major components of this revenue source include Local Sales Taxes, Consumer Utility Taxes, Business License Taxes, Motor Vehicle Licenses Taxes, and Meals Taxes.

Analysis:

The annual trend for elastic revenues as a percentage of total General Fund Revenues has been in a range of 30-31% until it increased in FY 2001 above 32%. For FY 2001, Local Sales Tax increased by 7% largely due to the development along Wards Road. During this year Meals Tax revenue increased 14% which included a rate increase from 5.5% to 6.0% effective July 1, 2000. For FY 2002, elastic revenues were less than FY 2001. Further, for FY 2003 a slight decline from FY 2002 is expected due to estimated lower Local Sales and Business License tax revenues.

Sales Tax Revenues

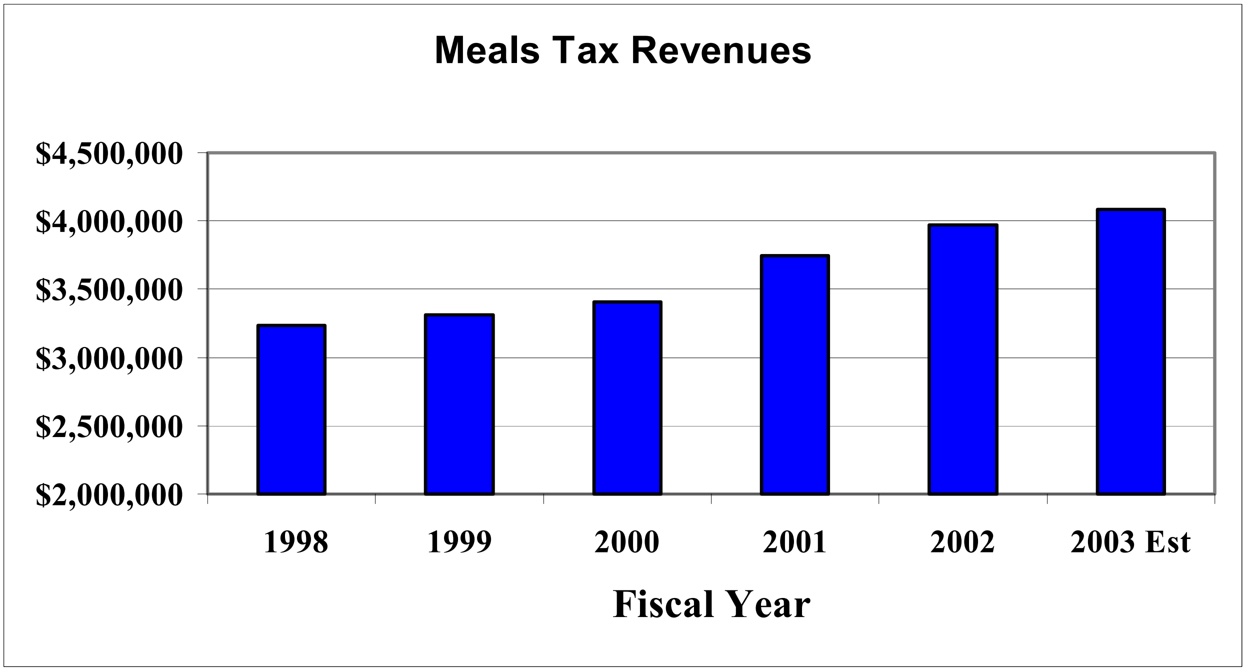


Warning Trend:
Declining or stagnant Sales Tax Revenues
(constant dollars)

Description:
The amounts have been adjusted to account for inflation.

Analysis:
In constant dollars, sales tax revenues increased steadily through FY 2001. During FY 2001 there was a real dollar increase of 5.6% that was primarily attributable to the development along Wards Road. In FY 2002, sales tax began to decline. For FY 2003, sales tax revenues are estimated to continue to decline due to the national recession.

Meals Tax Revenues

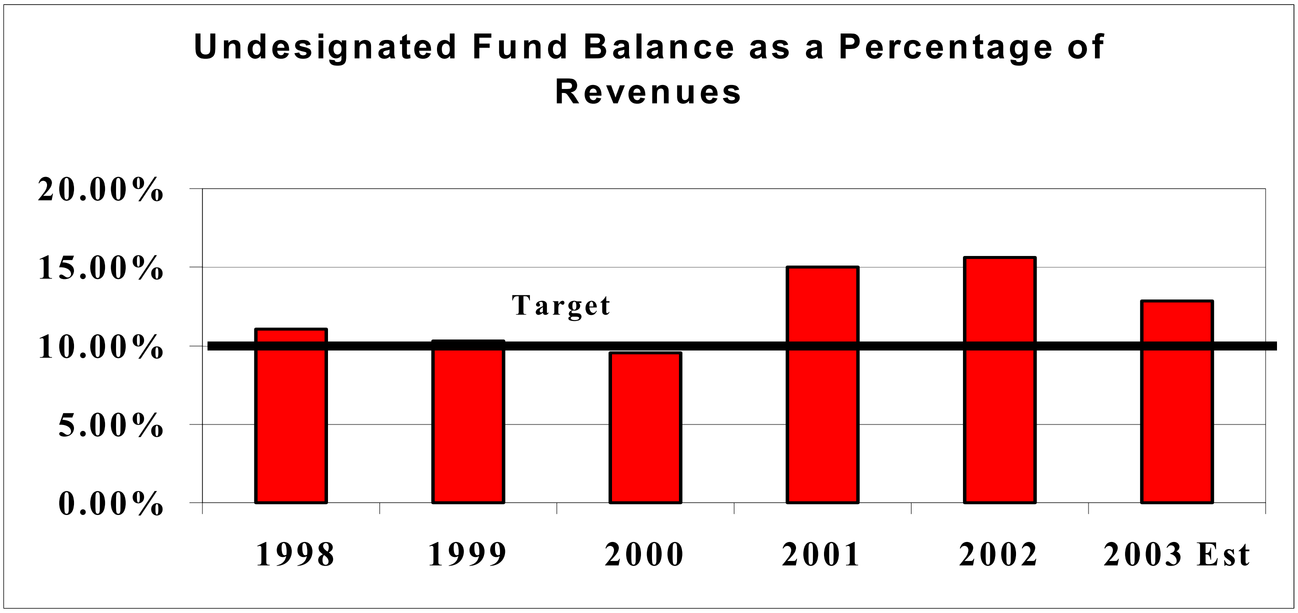


Warning Trend:
Declining or stagnant Meals Tax Revenues
(constant dollars)

Description:
The amounts have been adjusted to account for inflation.

Analysis:
In constant dollars, meals tax revenues experienced little growth from 1998 to FY 2000. Because of the restaurant development along Wards Road and the increased meals tax rate in FY 2001, this revenue source increased 9.5% in constant dollars compared to FY 2000. Restaurant development has continued along the Wards Road corridor in FY 2002 and FY 2003 thus sustaining some growth in this revenue source.

Undesignated Fund Balance

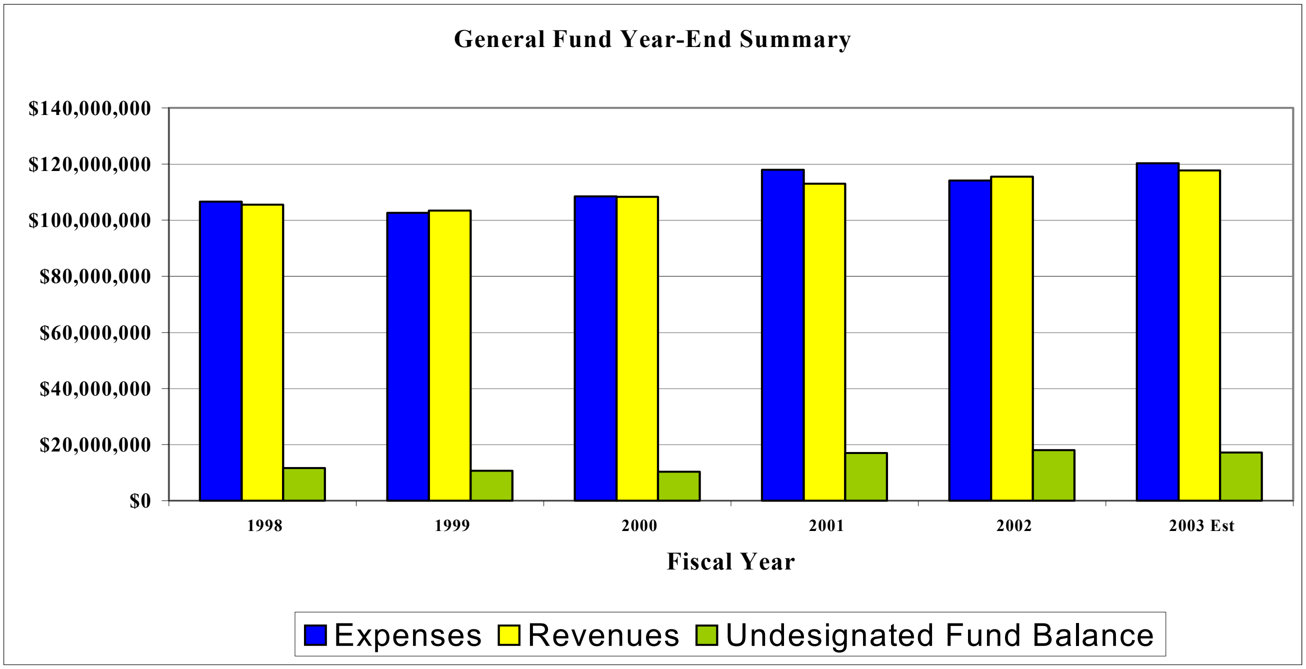


Warning Trend:
Declining Undesignated General Fund Balance as a percentage of revenues

Description:
In August 1999, City Council adopted a fund balance policy with a target balance of 10% and a minimum balance of 7%. The fund balance policy was revised and reaffirmed on October 29, 2002.

Analysis:
The declining trend for FY 1998 through FY 2000 was directly related to the operating surplus pattern. However, as contemplated with the adoption of the Fund Balance Policy for the General Fund during FY 2000, future budget development requires each year to stand on its own, balancing revenues with expenditures. Fund balance more than the 10% target is dedicated to one-time expenditures. The Undesignated Fund Balance was 15% for FY 2001, 15.6% for FY 2002, and is estimated at 14.6% for FY 2003, well within Council's policy.

General Fund Year-End Summary

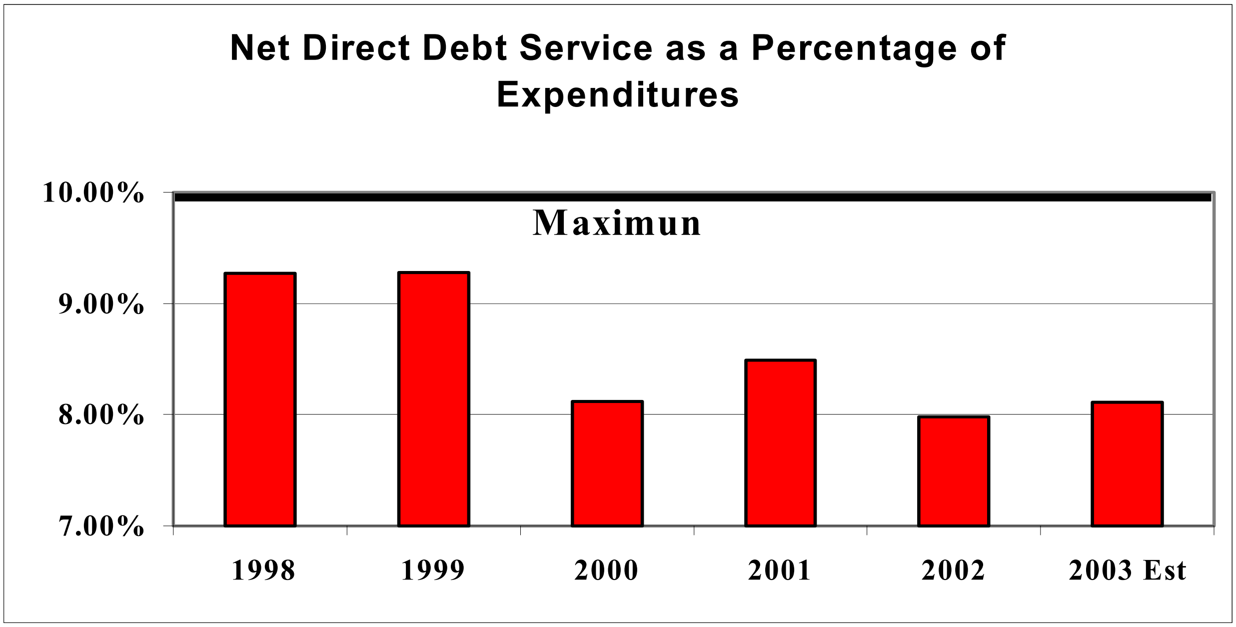


Warning Trend:
Use of one-time revenues for recurring expenditures

Description:
In FY 2000, City Council adopted a budget policy that requires that recurring expenditures be funded by recurring revenues. Further, the policy provides that one-time revenues be used for one-time expenditures only. City Council's fund balance policy allows funds in excess of the 10% target to be used for one-time expenditures.

Analysis:
Since adoption in FY 2000, the City has consistently followed the budget policy and in those instances where revenues were less than expenditures, the additional expenditures were attributable to pay-as-you-go capital transfers from fund balance in excess of 10% of revenues.

Annual Debt Service

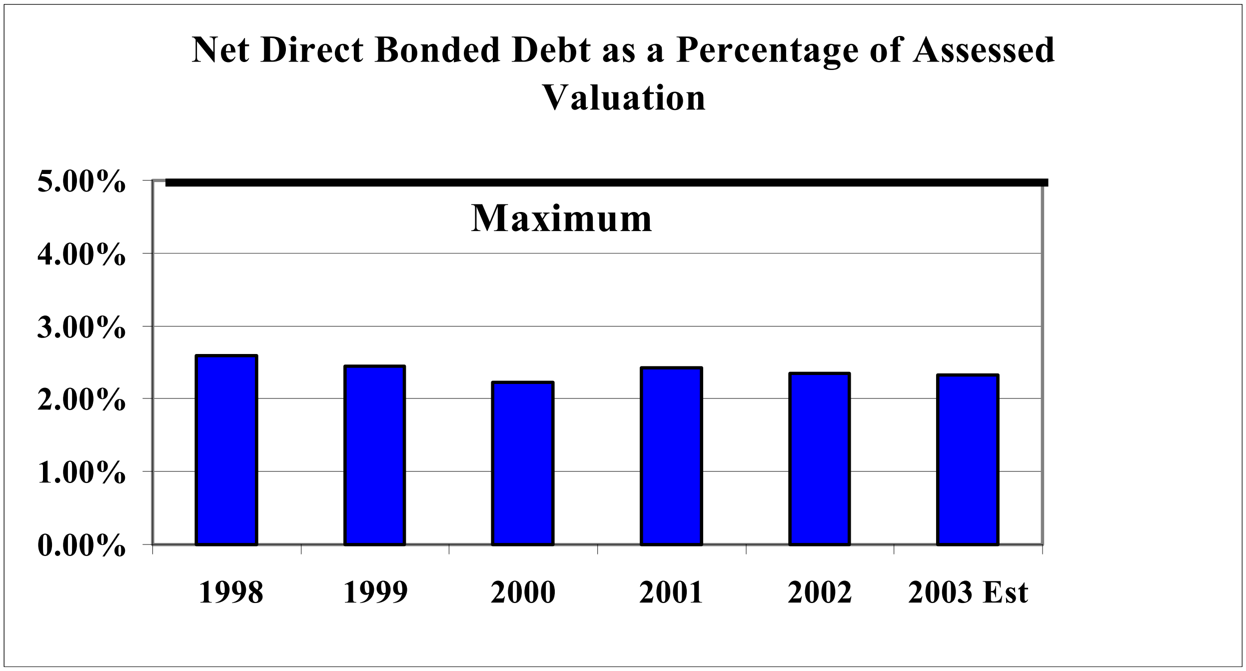


Warning Trend:
Increasing net direct-bonded long-term debt service as a percentage of expenditures

Description:
Debt service is defined as the amount of principal and interest that a local government must pay each year. City Council adopted as part of its debt management policies that net direct debt service would not exceed 10% of operating expenditures.

Analysis:
For the past three years, annual debt service has been approximately 8%. With the School construction program identified in the FY 2003-2008 Capital Improvements Program, debt service may exceed the 10% limit as defined in the Council-adopted debt management policies in the near future. This matter has been discussed with the bond rating agencies and because this is primarily attributable to the renovation of E C Glass High School, which is viewed as a one-time project, there should not be an impact upon the City’s bond ratings.

Long-term Debt



Warning Trend:
Increasing net direct-bonded long-term debt as a percentage of assessed valuation

Description:
Net direct bonded debt is direct debt minus self-supporting debt. Self-supporting debt is debt that the local government has pledged to repay from a source separate from general tax revenues (i.e. water, sewer, and solid waste). The bond rating agencies use a limit of 5% of assessed valuation as a strong credit indicator. A limit of 5% is a component of the Council-adopted debt management policies. The Code of Virginia limits bonded indebtedness to 10% of assessed valuation.

Analysis:
The City has consistently maintained a ratio at or below 2.5% for the past six years. With the increased borrowing associated with the School construction program, the ratio of net direct bonded debt as a percentage of assessed valuation may be in a range of 3.0% or higher but within the 5% limit.